March 11, 2004

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, N.W.
Washington DC 20551

Re: Comments to Proposed Amendments To Regulation CC
Docket No.: R-1176

Dear Ms. Johnson:

The undersigned financial services industry organizations and technology companies (the "Commenters") have jointly prepared the attached comments to the Federal Reserve Board's proposed regulation (the "Proposal") to amend Regulation CC to implement the Check Clearing for the 21st Century Act (the "Check 21 Act").

The attached document reflects the collective efforts of the undersigned Commenters. The Commenters have identified the issues discussed below as the most significant issues under the Proposal, and have worked together to set forth their views on these issues. Certain of the undersigned Commenters may submit separate comment letters on the Proposal concerning issues discussed in this letter as well as other issues.

If you have any questions regarding our comments to the Proposal, please contact any of the representatives of the undersigned Commenters. Given the substantial nature of these comments, particularly the comments relating to MICR line creation and repair

issues, we believe it would be appropriate to meet with representatives of the Board and other interested parties to discuss these comments and any other issues arising under the Proposal.

Sincerely,

America's Community Bankers	American Bankers Association
Bank of America, N.A.	Bank One
BB&T	BITS
Citigroup Inc.	Comerica
Credit Union National Association	Deutsche Bank Trust Company America's
EDS Information Services	Electronic Check Clearing House Organization (ECCHO)
Electronic Clearing Services L.L.C.	Electronic Payments Network L.L.C.
Fiserv	Fleet Bank
Frost Bank	HSBC
Huntington Bancshares Incorporated, Columbus OH	Independent Community Bankers of America
JPMorgan Chase Bank	KeyBank
Mid-America Payment Exchange	NACHA -- The Electronic Payments Association
National Association of Federal Credit Unions	National Clearing House Association (NCHA)
NCR Corporation	PNC Bank
Southern Financial Exchange	The Association of Corporate Credit Unions
The Clearing House	The Financial Services Roundtable
The National Check Exchange Company Company L.L.C.	The Puerto Rico Clearing House Association, Inc.
The Small Value Payments Company L.L.C.	Union Bank of California
USBank	Wachovia Corporation
Wells Fargo & Company	WesCorp
Wisconsin Automated Clearing House Association (WACHA)	

1. MICR Line Issues: Creation and Repair of MICR line on Substitute Checks

The Proposal sets forth rules for creating and repairing the MICR line on a substitute check. See, Commentary to Section 229.2(zz) (definition of substitute check) and Section 229.51(c) (Purported Substitute Check). The Proposal provides that a reconverting bank may correct an amount encoding error and should correct a MICR-read error from the original check. The Proposal provides that the failure to correct the amount on the MICR field of the substitute check does not affect the status of the substitute check as the legal equivalent to the original check. However, the Proposal provides that a substitute check that does not accurately reproduce the MICR information from the original check, for example because of a MICR read error, would not be a substitute check under the Check 21 Act -- that is, there is no legal equivalency -- but would be subject to the warranties, indemnities and recredit rights applicable to substitute checks.

We are very concerned that the Proposal's rules regarding the initial placement and any subsequent repair of a MICR line on a substitute check will unnecessarily introduce new liabilities into the check collection system and will create uncertainty as to how substitute checks should be handled. The Proposal's rules also will result in substitute check recipients, including consumers, being unable to determine the rights they have with regard to the substitute checks they have received. We strongly urge the Federal Reserve to revise these MICR line rules as currently set forth in the Proposal and to provide additional clarification on the ability of banks to repair a MICR line on a substitute check. We have set forth below our detailed views as to how these MICR line issues should be addressed.

A. Placement of MICR Line On Substitute Check By Reconverting Bank

The final rule should provide that a reconverting bank has an obligation to print the MICR information from the original check in MICR ink on a substitute check that it creates. This substitute check MICR line must contain all the MICR line information appearing on the original check (regardless of whether the MICR line on the original check was encoded properly by a prior bank). If a reconverting bank fails to put a MICR line on a substitute check that matches the MICR line on the original check, the reconverting bank has violated the Check 21 Act and the regulations which require that the substitute check: (i) bear a MICR line containing all the information appearing on the MICR line of the original check, and (ii) be suitable for automated processing. The reconverting bank would also have violated the encoding warranties under Regulation CC and the Uniform Commercial Code ("UCC") which provide that a bank warrants that information encoded after issuance in magnetic ink on the check or returned check is correct. See 12 C.F.R. 229.34(c)(3); UCC Article 4-209.

However, the failure of the reconverting bank to place a MICR line on a substitute check that matches the MICR line on the original check does not result in a breach of the Check 21 Act warranty requiring the substitute check to meet all of the Act's requirements for legal equivalence. Notwithstanding the incorrect MICR line, the image of the original check on the substitute check "accurately represents all of the information on the front and back of the original check" as required under Section 5 and Section 4 of the Act.

Unlike the approach set forth in the Proposal, we also believe that, even if the MICR line on the substitute check does not accurately represent the MICR line on the original check, the substitute check should still qualify as the legal equivalent of the original check. Under this approach, the MICR line of the substitute check could vary from the MICR line of the original check in the amount field, the routing and transit fields, or in any other field. In all cases, provided the reconverting bank places a MICR line on the substitute check in MICR ink, the substitute check retains its legal equivalence to the original check.

We believe this approach to the legal equivalency of the substitute check best serves the operating needs and expectations of the parties processing and receiving substitute checks. The status of a substitute check that contains MICR information in MICR ink as the legal equivalent of the original check for all parties down the check collection chain should not be dependent on whether the MICR line is properly read from the original check and printed on the substitute check. Banks in the check collection process, such as collecting banks and paying banks, that receive a substitute check, and the nonbank parties that receive substitute checks (e.g., the drawer), need to know that they can process that substitute check and treat it as the original check. In many cases, a collecting bank will not know that there is an error in the MICR line of a substitute check that the bank receives from a reconverting bank, and the collecting bank will transfer that check to a subsequent collecting bank or to the paying bank. If the collecting bank does determine that it has received a substitute check with an incorrect MICR line, the collecting bank should be permitted to repair the MICR line on the substitute check and transfer the substitute check to the paying bank or to another collecting bank.

Under the Proposal, a collecting or paying bank that receives a substitute check and determines that it contains an error on the MICR line would be required as a practical matter to return that substitute check to the reconverting bank. As, under the Proposal, the substitute check is not the legal equivalent to the original check, the collecting bank has no authority to repair the substitute check or to present the check to the paying bank for payment. Similarly, a paying bank would have no authority to charge its customer account, even if the paying bank could determine that the substitute check was otherwise properly payable, notwithstanding the MICR encoding error. These results are contrary to the main goal of the Act to encourage the acceptance and collection of substitute checks.

The paying bank and the drawer (or the depositary bank and the depositor in the case of a returned substitute check) also generally will not know that they have received a

substitute check with a MICR line that does not match the original check, and that is not under the Proposal the legal equivalent of the original check. It is not fair to these parties -- and certainly will discourage the acceptance of substitute checks -- to provide to them something that looks to them like a substitute check but does not carry the legal equivalence of a substitute check.

As a related issue, we believe that the final rule should clarify that a reconverting bank may repair a MICR line on a substitute check after creating that substitute check. This repair of a substitute check would involve the addition of a strip to the bottom of the check and the printing of the correct MICR line information on the strip. This would permit a reconverting bank to correct any portion of the MICR line on a substitute check if the bank realizes, after the creation of the check, that the MICR line information on the substitute check is incorrect and will result in an error in the delivery or processing of the substitute check. The repair of a substitute check by the reconverting bank should not affect the status of the substitute check as the legal equivalent of the original check.

We propose the below Commentary text to implement the above position.

Proposed Text For Commentary:

"Section 229.2(zz); Definition of Substitute Check: (##) A reconverting bank shall encode a substitute check in MICR ink with the MICR line information appearing on the original check, except as provided under generally applicable industry standards. A reconverting bank may repair the MICR line of a substitute check after the creation of the substitute check. An inaccurate MICR line on a substitute check as a result of repair or creation does not affect the status of the substitute check as the legal equivalent of the original check."

In the event that a reconverting bank fails to place a MICR line on a substitute check that matches the original check's MICR line and a collecting bank or paying bank experiences a loss as a result, including a potential loss from the paying bank's liability for consequential damages to a customer (such as damages for wrongful dishonor), the collecting bank or paying bank should be protected under existing check law. Under the UCC, the reconverting bank would warrant that all MICR line information on the substitute check is "correctly encoded." UCC 4-209(a). The UCC provides that a person recovering under this warranty may recover damages in an amount equal to the "loss suffered as a result of the breach," plus expenses and lost interest. UCC 4-209(c). A warranting bank would be liable under this UCC section for consequential damages, such as damages arising at the paying bank as the result of wrongful dishonor of subsequent checks due to the encoding error. See B. Clark & B. Clark, Law of Bank Deposits, Collections and Credit Cards, Section 16.03[2]. We believe that, given the importance of the MICR line encoding to the processing of a substitute check, this liability should be passed back to the reconverting bank in the manner provided under the UCC encoding warranty.

We request that the final rule include in the Commentary the above interpretation of the application of the UCC encoding warranty to a substitute check that (i) has MICR line information that does not match the MICR line information on the original check or (ii) does not include the proper encoding in position 44 according to the generally applicable industry standards for substitute checks. Recognizing that the 1990 amendment to UCC Section 4-209 has not been adopted in each of the states, we also request that the Federal Reserve revise the damage provision under Section 229.34(d) of Regulation CC to provide that, with respect to substitute checks only, in the event of a breach of the encoding warranty a warranting bank is liable for the same damages that could be recovered by a claimant bank under UCC Section 4-209(c). An alternative to this approach would be for the Federal Reserve to otherwise revise Subpart D of Regulation CC to directly provide that liability arising from a MICR encoding error on a substitute check, including potential consequential damages that a paying bank must pay to its customer, is appropriately passed back to the reconverting bank.

B. Repair of Substitute Check by Collecting/Paying Bank

The Proposal does not provide sufficient guidance as to the ability of banks, other than the reconverting bank, to repair a MICR line on a substitute check that is received in the check collection process. We believe that any rules under the Check 21 Act for repair of a substitute check should be designed to encourage banks to treat a substitute check in the same manner as an original paper check.

We recommend that the final rule under the Check 21 Act provide that a collecting bank or a paying bank may, at its option, repair any portion of a MICR line on a substitute check that it receives in the check collection process. There should be no obligation under the Check 21 Act for a collecting bank or a paying bank to repair the MICR line on a substitute check. If a collecting or paying bank does repair a substitute check, that repair should not implicate the Check 21 Act, regardless of whether the repair is done correctly or incorrectly and regardless of whether a full or partial MICR line is placed on the repaired substitute check. The repair of a substitute check by a collecting bank or paying bank would not implicate the warranties under the Check 21 Act because a repair of a MICR line does not affect whether or not the image of the original check printed on the substitute check accurately reflects the information from the original check. Furthermore, a substitute check that is repaired should not lose its status as the legal equivalent to the original check, regardless of type of repair (full or partial) and regardless of the accuracy of repair. Rather, the collecting bank or paying bank that repairs a substitute check in a manner that results in an inaccurate MICR line information (full or partial) would breach the encoding warranties under the UCC and Regulation CC.

We believe that the above proposed treatment of repair by collecting banks and paying banks would encourage equivalent treatment of checks in the check collection process. Banks engaging in repair of a substitute check should treat the substitute check in the same manner they would handle an original check today. No new risks or potential for errors are created by the repair of a substitute check, compared to the repair of an original check today. Given that there are no new potential risks, the Check 21 Act

should not alter the liabilities among banks for repair of a substitute check. If the final rule imposes new liabilities under the Check 21 Act on banks engaged in the repair process, these liabilities and responsibilities would alter the incentives for banks to engage in repair and would degrade the check system accordingly. For example, a collecting bank may refuse to repair any substitute checks if it decides that the Check 21 Act liability is unacceptable, resulting in increased costs to the check collection system to process such unrepaired checks.

We propose the below Commentary text to implement the above position.

Proposed Text For Commentary:

"Section 229.2(zz); Definition of Substitute Check: (##) A bank may repair the MICR line on a substitute check. A repair that alters the MICR line of a substitute check such that it does not accurately represent the MICR line of the original check does not result in a breach of a warranty under the Check 21 Act, although it may result in a breach of the encoding warranties prescribed in the Uniform Commercial Code (Article 4-209) and Section 229.34 of this Regulation (see e.g., the Section 229.34(c) encoding warranties). Repair of a substitute check does not affect the status of the substitute check as the legal equivalent of the original check."

C. Issues Relating to Position 44 on the MICR Line

We seek clarification in the final rule regarding the treatment of the unique codes in position 44 on the MICR line of the substitute check. The generally applicable industry standards currently contemplate that the reconverting bank will place a "4" in position 44 on all substitute checks in the forward collection process, and a "5" will be placed on the qualified return strip of a substitute check in the return process.

We seek clarification under the final rule that, if a reconverting bank or a repairing bank fails to correctly place a required code in position 44 in compliance with the generally applicable industry standards, that failure (i) would not affect the status of the substitute check as the legal equivalent of the original check, and (ii) would not constitute a breach of the Check 21 Act warranties. Rather, it is our view that the failure to properly encode position 44 on a substitute check would constitute a violation of the Check 21 Act or the regulations which require adherence to the generally applicable industry standards for substitute checks. While this violation of the Act and regulations could result in liability for the amount of the substitute check, to the extent that a loss arose, there would be no recovery under the Check 21 Act of any consequential damages that may arise from this violation. With respect to the legal equivalency issue, we have discussed in the prior sections of this letter the reasons why the correct or incorrect MICR line information should not affect the legal equivalence of a substitute check. The same rationale applies to the position 44 encoding on a substitute check.

We recognize that the failure of a reconverting bank or a collecting bank to correctly encode position 44 on a substitute check could have consequences for subsequent banks in the check collection process. In particular, a subsequent bank may create a second substitute check from the prior substitute check (or image thereof). Without the proper encoding in position 44, this second substitute check could contain a "shrunken" image of the original check because the second reconverting bank was not put on notice to preserve the size of the image of the original check. In such a case, it is possible that the second reconverting bank could have liability to a receiver of that second substitute check, including consequential damage liability, for a breach of the Section 5 warranties. However, it would appear that the second reconverting bank would not have a claim against the first reconverting bank for such consequential damages because the first reconverting bank did not breach a Check 21 Act warranty when it failed to correctly encode position 44. As indicated above in Section A, we request that the Federal Reserve provide in the Commentary that the failure to properly encode position 44 on a substitute check would constitute a breach of the encoding warranty under the UCC, or that the Federal Reserve otherwise address this liability issue in Regulation CC.

We propose the below Commentary text to implement the above position.

Proposed Text For Commentary:

"Section 229.2(zz); Definition of Substitute Check: (##) A bank that fails to properly encode position 44 on a substitute check, or otherwise fails to comply with the generally applicable industry standards for encoding a MICR line on a substitute check, does not breach a warranty under Section 5 of the Act; although it may breach the Section 3(16) requirement of the Act that the substitute check conform to generally applicable industry standards. Failure to encode position 44 in compliance with the generally applicable industry standards does not affect the status of the substitute check as the legal equivalent of the original check."

2. Purported Substitute Checks

The Act requires that, in order for a document to meet the requirements of the definition of a "substitute check," the check must, among other requirements, (i) bear a MICR line with the MICR information from the original check, and (ii) be suitable for automated processing in the same manner as the original check. Section 229.51(c) of the Proposal provides that if a bank transfers and receives consideration for an item that meets all the requirements of a substitute check except for the MICR line requirement in Section 229.2(zz)(2), that item is a substitute check for purposes of the expedited recredit, indemnity and warranty provision of the Check 21 regulation. However, Section 229.51(c) provides that such an item is not a legal equivalent of the original check. We believe that Section 229.51(c) raises two related issues regarding MICR lines on substitute checks. These two issues are discussed below.

A. Remove Section 229.51(c) from the Final Rule

We believe that Section 229.51(c) should be deleted in its entirety from the final rule. As discussed in the prior section, there is no reason why an item that otherwise meets the requirements for a substitute check, but contains incorrect MICR encoding, should not have legal equivalency to the original check. Given receiving banks' and customers' potential lack of knowledge of an imperfect MICR line on a substitute check, it does not seem appropriate to "punish" receivers of a substitute check by denying the substitute check "legal equivalency" because the MICR line on the substitute check fails to accurately represent the MICR line on the original check. The liability provisions under the Check 21 Act would protect banks and customers that receive such a substitute check, to the extent that a loss arises from the incorrect MICR encoding.

Accordingly, we request that the Purported Substitute Check provision of the Proposal be deleted in its entirety in the final rule. The final rule should instead include the provisions, discussed in the prior section, regarding the legal equivalency of a substitute check, notwithstanding incorrect or altered MICR line information.

B. Creation Of A Substitute Check Without MICR Ink By Paying Bank

We request the final rule include a new provision that expressly authorizes a paying bank to create a legally equivalent substitute check without printing the MICR line information in MICR ink. Substitute checks that are paid and canceled by the paying bank and are delivered by the paying bank to its drawer customers, do not need to be printed in MICR ink. These substitute checks will not be further processed on an automated basis, either on a forward collection or return basis. Accordingly, it is not reasonable to require a paying bank to incur the cost of using MICR ink to create this class of substitute checks. From a customer's point of view, it will not matter whether the MICR line is printed in MICR ink. As customers do not use MICR line readers and can visually read all the information on the substitute check, including the information contained in the MICR line, there is no detriment to customers to receiving a non-MICR ink substitute check. Indeed, a customer will not be able to tell that the substitute check lacks MICR ink.

By authorizing non-MICR ink substitute checks in the final rule, the Federal Reserve will further the purposes of the Act to facilitate check truncation and improve the efficiency of the nation's payments system. It is generally anticipated that it will be less expensive to print a non-MICR ink substitute check, and therefore, paying banks can produce non-MICR ink substitute checks on a cost-effective basis to reach those customers who have not agreed to receive images of their checks. With this lower cost capability, paying banks will be more willing to enter into arrangements with other banks to exchange only check image files, instead of exchanging a mix of paper checks and check images. This will allow depositary and collecting banks to image a greater number of checks much earlier in the check collection process.

In authorizing the creation of a non-MICR ink substitute check, the final rule should clarify that an item must meet all the other requirements under the Act, the regulation and industry standards to be deemed a "substitute check" under the Act and regulation. For example, the non-MICR ink substitute check must have the appropriate legend and be printed in accordance with industry standards as to size and paper quality. Compliance with these other requirements for a substitute check will ensure that copies of checks or check image statements are not unintentionally brought within the scope of the Act.

We propose the below Regulatory text to implement the above position.

Suggested Regulatory Text:

"Exemption From Requirement to MICR Ink Encode Substitute Checks: A paying bank may, at its option, print the MICR line information from the original check on a substitute check with non-MICR ink, and such substitute check does not otherwise need to be suitable for automated processing in the same manner as the original check, provided: (i) the check has been paid by the bank and will not be further processed on an automated basis through the forward or return bank check collection process; (ii) the paying bank is delivering the substitute check to its own customer; (iii) the information from the MICR line on the original check is printed in non-MICR ink and in MICR font on the substitute check in the same location as on the original check; and (iv) the paying bank otherwise complies with the requirements for substitute checks under the Act. In this situation, this substitute check without MICR ink would be deemed to satisfy the requirements of a "substitute check" for all purposes under the Act and this regulation."

3. Definition of "Transfer and Consideration"

Section 229.2(bbb) of the Proposal provides a new definition of "transfer and consideration" to include the transfer of a substitute check (or other representation of the substitute check) to a person other than a bank. This new definition clarifies that a "transfer" includes the transfer of a substitute check from a paying bank to its customer, and that the Check 21 applies to the paying bank's creation and transfer of a substitute check to its customer. We support this new definition as set forth in the Proposal, as well as the example in the Commentary to Section 229.2(bbb) of a paying bank creating a substitute check for delivery to its customer. We believe the ability of a paying bank to create and deliver a substitute check to its customer was a process that the Act is intended to authorize.

We also recommend that the text of the definition of "transfer" in Section 229.2(bbb)(2)(i) be revised to clarify that the term "check" refers to the original check and any representation thereof. The use of the term "check" in the Proposal could be interpreted too narrowly. We have set forth suggested text below.

Suggested Regulatory Text:

"Section 229.2(bbb)(2)(i): Except as provided in paragraph (bbb)(2)(ii) of this section, a bank that transfers a substitute check or a paper or electronic representation of a substitute check directly to a person other than a bank has received consideration for the substitute check or other paper or electronic representation of the substitute check if it has charged, or has the right to charge, the person's account or otherwise has received value for the *original* check *or a representation thereof."* [New text in italics].

4. Treatment of Generally Applicable Industry Standards

In the Proposal, the Federal Reserve requested comment on its proposed treatment of generally applicable industry standards. The Federal Reserve proposes to include only a reference to "generally applicable industry standards" in the rule text; and if only one standard applies, the Commentary would identify this standard. However, the approach in the Proposal would not identify the applicable standards to the exclusion of other standards that may develop over time.

We believe that the final rule needs to provide sufficient certainty and predictability to the financial services industry as it attempts to develop and implement expensive and complex operating and technological systems to handle substitute checks. Without specific identification of the applicable standards in the final rule, there is the potential for uncontrolled proliferation of industry standards as new groups could deem that they have created a new "generally applicable industry standard;" and thus, compliance with their "standard" satisfies the Act. There is no formal process for determining what constitutes a "generally applicable industry standard," and potentially a small number of banks or other entities could claim to have created such a standard. This will result in confusion and uncertainty as banks must comply with potentially a multitude of "standards" for their different exchanges. There will be uncertainty about whether a particular standard that is not included in the Commentary examples is, in fact, a "generally applicable industry standard" for purposes of the Act. We believe the need for certainty regarding the substitute check standards is a unique problem for substitute checks because there is not sufficient operating experience for the financial services industry to determine with certainty that competing standards with different requirements will not be developed in the near term.

We recommend that the Federal Reserve clarify in the final rule that the generally applicable industry standards that are identified in the Commentary are an exclusive list of generally applicable industry standards. That is, until a standard is identified in the Commentary, it does not qualify as a generally applicable industry standard for purposes of the Check 21 Act. In addition, the Commentary to the final rule should identify the substitute check standard as issued by the Accredited Standards Committee (ASC) X9, Inc. as the only current generally applicable industry standard for substitute checks. The Commentary should allow for these industry standards to be re-named and re-issued from time to time without requiring an immediate change to the Commentary. As new

standards are developed, the Federal Reserve can propose changes to the Commentary to recognize them as "generally applicable," and thereby give the financial services industry the opportunity to comment on whether such a standard should be deemed a "generally applicable industry standard."

We have set forth suggested Commentary text below.

Suggested Commentary Text:

"Commentary Section 229.(##): Generally Applicable Industry Standards. The 'Specifications for an Image Replacement Document – IRD,' issued by the Accredited Standards Committee (ASC) X9, Inc., shall constitute the exclusive generally applicable industry standard for substitute checks. This standard may be amended and revised from time to time by the Accredited Standards Committee (ASC) X9, Inc. or any successor organization thereto."

5. Delivery of Notice at Time of Consumer Request for Copy of Check

In the Proposal, the Federal Reserve requested comment on two alternatives for a financial institution to meet the obligation to deliver the consumer education document when a financial institution is delivering a substitute check to a consumer after the consumer requests a copy of the check. See Section 229.57(b)(2). The two alternatives in the Proposal are: (1) at time of request for an original or copy of a check, or (2) at the time the financial institution provides a substitute check.

We strongly support the second alternative for delivery of the notice at the time the financial institution provides the substitute check. We also recommend that the final rule permit the financial institution to provide the notice to the consumer at any time after the request, up to and including the time the substitute check is delivered to the consumer. Under this approach, a financial institution could mail, or otherwise provide, the notice to the consumer ahead of the delivery of the substitute check, or provide the notice along with the substitute check. This approach provides additional flexibility to financial institutions and does not undercut the value of the disclosure to the consumer because in all cases the consumer receives the consumer education notice either before or at the time the substitute check is received. We believe that this approach for delivery of the notice is consistent with the requirement of Section 12 of the Act, which requires the notice "at the time of the request." The phrase "at the time of the request" should be interpreted to mean any time from the time the initial request is made until the time that the bank responds to the consumer's request.

The first alternative, delivery of the notice at the time the request is made, raises some operational difficulties. A bank may not know at the time the consumer makes the request for the copy that the bank will satisfy the request by providing a substitute check. For example, it may take a day or two after the request is made for the bank to process the request in its operations center and determine whether the original paper check, an image, a photocopy or a substitute check is going to be provided to the consumer. Also,

given this potential for a delay between the request and the delivery to the consumer, the notice would be more effective if delivered to the consumer with the substitute check, rather than at the time the request is made. That way, the consumer would have the notice with the substitute check to which the notice relates. Finally, it often may be more efficient for the bank to provide the notice with the substitute check.

We propose the below Regulatory text to implement the above position.

Suggested Regulatory Text:

"Section 229.57(b)(2) . . . (i) Requests an original check or a copy of a check and receives a substitute check, by or at the time the bank provides such substitute check."

6. Application of Section 5 Warranty to ACH and Electronic Funds Transfers

The Proposal seeks comment as to whether a duplicate debit resulting from an ACH debit or other electronic fund transfer (referred to herein as an "ACH debit") created using information from the original check or substitute check results in a violation of the Act's duplicate payment warranty. Under Section 5(2) of the Act, a bank that transfers, returns or presents a substitute check warrants that no depositary bank, drawee, drawer, or endorser will receive presentment or return of the substitute check, the original check, or a copy or other paper or electronic version of the substitute check or original check such that such person will be asked to make a payment based on a check that the bank has already received.

It is our strongly-held view that the Section 5(2) warranty should not apply to a second debit that results from an ACH debit that is created with information from the original check or a substitute check. The Section 5(2) warranty provides that the bank, drawee, drawer or endorser will not be asked to make a "payment based on a check that the bank, drawee, drawer or endorser has already paid." An ACH debit initiated with a check is not an "electronic version of the substitute check or original check" because the ACH debit represents a new payment transaction and is not in any way a continuation of a check transaction. Similarly, a payment for an ACH debit is not a "payment based on a check" because the ACH debit is processed through the ACH network and is subject to the ACH rules and consumer protections applicable to electronic funds transfers. These ACH and electronic funds transfer rules provide appropriate protection to the customer whose account was wrongly debited for the ACH debit and appropriate liabilities for the originator of that ACH debit.

We propose the below Commentary text to implement the above position.

Suggested Commentary Text:

"Section 229.52(a)(2). A reconverting bank that has presented a substitute check to a paying bank would not be in breach of the warranty under Section

229.52(a)(2) and Section 5(2) of the Act in the event that an electronic fund transfer, such as an ACH debit, is subsequently initiated using information obtained from the original check or the substitute check relating to that original check. An electronic funds transfer does not result in a "payment based on a check" that would cause a breach of this warranty. The customer whose account was inappropriately debited for this electronic fund transfer would have the protection provided under electronic fund transfer law."

7. Model Consumer Educational Document

It is our view that the model disclosure for the consumer education document included in the Proposal is too long and detailed. By its very terms, the Check 21 Act requires a bank to provide a "brief notice" regarding the consumer recredit rights and the legal equivalency of the substitute check. The Check 21 Act does not require a complete restatement of the entire consumer recredit provisions. It is not necessary, as a legal or as a practical matter, to provide consumers with a complete restatement of the expedited recredit right procedures under the Act. The key point that consumers need to understand from the education disclosure is that they should contact their financial institution if they have a problem with a substitute check and that they may have consumer protections, in addition to other protections generally provided to them under existing check law. Having the notice restate the entire expedited recredit section from the Act is not necessary, as financial institutions are required to honor those rights when contacted by a consumer alleging a dispute with a substitute check. Moreover, it is not certain that a long and detailed education notice will be effective. Consumers may be discouraged from reading a very long disclosure regarding the details of the Check 21 Act or unnecessarily confused by the complexity of the proposed model disclosure.

We recommend that the final rule contain a significantly shorter model form for financial institutions to use to satisfy the requirement to deliver a consumer education notice. We believe this shorter text fulfills the express requirement of the Act to provide a "brief notice" of the legal equivalency of the substitute check and the expedited recredit rights of the consumer.

We have prepared the text below for consideration. However, even if the below text is not acceptable for the final rule, we still strongly urge the Federal Reserve to reduce the size and complexity of the model notice in the final rule.

Model Disclosure:

"You may receive from us in certain cases a substitute check, instead of the original check you wrote. For example, you may receive a substitute check, instead of an original check, in your account statement, when you request a copy of a paid check, or when checks that you deposited are returned unpaid and charged back against your account. A substitute check is a copy of the original check that is the same as the original check for all purposes, including proof that you made payment. A substitute check is the size of a typical business check,

includes an accurate copy of the front and back of the original check, and contains the words: 'This is a legal copy of your check. You can use it the same way you would use the original check.'

Federal law provides consumer customers with certain rights, including an expedited recredit of the amount of the check (up to $2,500 within 10 days and the remainder no later than 45 days), plus interest for interest bearing accounts, if you incur a loss because you received a substitute check instead of your original check. We may reverse a recredit after our investigation of your claim, if we determine that the substitute check was properly charged to your account. You must contact us within 40 calendar days of the later of (i) your receipt of your monthly statement showing the substitute check being charged to your account, or (ii) the date we made the substitute check available to you. We may in certain cases extend this 40 day time period. If you believe you incurred a loss because you received a substitute check, please contact us by [insert bank contact information]."

8. Other Model Documents

The Proposal includes a number of other model disclosures that financial institutions may use to satisfy various notice and disclosures requirements under the Act. We believe that these notices are helpful to the financial services industry and will provide useful uniformity to the notices. We support the inclusion of these other model notices in the final rule.

We recognize that the Act does not provide the Federal Reserve with authority to provide a compliance "safe harbor" to financial institutions that use these other model notices. However, we request that the Federal Reserve indicate in the final rule that the use of the notices by a financial institution, in the view of the Federal Reserve, would constitute compliance with the Act. Such a statement as to the Federal Reserve's view on the use of these model notices should provide support for a finding of compliance by a court or other alternative dispute forum.

9. Breach of UCC Warranties As Precondition To Expedited Recredit

Under the Check 21 Act, one of the preconditions to a consumer making a claim for expedited recredit under Section 7 of the Act is that the consumer must assert, among certain other required elements, that the consumer has a "warranty claim with respect to such check." While the type of warranty claim is not specifically identified in the Act, it was a general assumption that the warranty claim referred to in the Act was a warranty under Section 5 of the Act. However, the Commentary to Section 229.54(a)(2) of the Proposal states that a consumer may make an expedited recredit claim for a breach of UCC warranties with respect to a substitute check.

We request that the Federal Reserve remove this provision from the final rule and clarify in the final rule that the warranty claim precondition for an expedited recredit

claim must be a breach of a warranty under the Check 21 Act. The purpose of the Check 21 Act was to authorize the creation and use of substitute checks, and in certain cases provide receivers of substitute checks with additional protections. The Check 21 Act was not intended to alter the manner in which current check law applies to a substitute check or the manner in which banks resolve disputes with their customers under current check law.

By allowing the customer to bring a claim based on a warranty arising under other check law, such as Regulation CC or the UCC, there will be an unnecessary mixing of the dispute resolution process for substitute check claims and the standard dispute process for other check law claims.

We request that the Federal Reserve remove this provision from the final rule.

10. Remotely-Created Demand Drafts

In the Proposal the Federal Reserve requests comment on whether it would be appropriate to incorporate into Regulation CC the latest NCCUSL amendments to Articles 3 and 4 relating to remotely-created demand drafts. In summary, the new amendments to UCC 3 and 4 would establish a new transfer and presentment warranty whereby the transferor warrants that with respect to a remotely-created demand draft "the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn."

We support the Federal Reserve revising Regulation CC to provide a new warranty relating to remotely-created demand drafts. We would propose that the final rule on this matter include some minor changes to the warranty from the version of the warranty set forth in the NCCUSL amendments to Articles 3 and 4. First, the warranty should apply to all demand drafts, not just demand drafts that are drawn against consumer accounts. We see no basis for distinguishing between consumer and non-consumer accounts in this regard. Second, we would recommend that the new warranty under Regulation CC warrant that the item is authorized according to all the terms of the item, not just the amount of the item. This second recommendation in consistent with the laws in a number of states that have adopted provisions relating to unsigned demand drafts.

We strongly support the Federal Reserve moving quickly to revise Regulation CC to include a new warranty regarding demand drafts. However, given that the issue of demand drafts does not have the same time urgency as the provisions implementing the Check 21 Act, we request that the Federal Reserve provide a second proposal on this issue to provide the financial services industry with the opportunity to review and comment upon the text of the proposed change to Regulation CC before it is implemented.

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